

**STATE BOARD OF EQUALIZATION**

916/445-6493

September 20, 1984

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Attention: Mr. --- ---

This is in reply to your letter dated August 3, 1984, to Mr. Gary Jugum, Assistant Chief Counsel, wherein you request several rulings regarding exemptions from sales and use taxes on the acquisition, sale, and leaseback of cargo containers and chassis by your client, [A].

Only the Board of Equalization itself can issue rulings, we can, however, give you our opinion in this matter.

The facts, as supplemented and clarified by [B] in her letters to me dated August 14, 1984, and August 15, 1984, and in my telephone conversations with her on August 20, 1984 and September 4, 1984, are as follows:

The taxpayer, [A], is a United States flag common carrier engaged in worldwide ocean shipping operations. [A] is one of the largest U.S. carriers operating on numerous major trade routes from United States ports to Europe, Africa, and the Orient. [A]'s vessels and barges carry cargo containers throughout the world. [A], however, does not conduct intrastate shipping operations in California: that is, [A] does not engage in the business of transporting cargo from point to point within California.

[A] will purchase 5,465 cargo containers and 1,890 chassis from different manufacturers. It will resell them within a brief period of time to [an owner "Trust"]. The Trust will then lease back the containers and chassis to [A], the containers and chassis are being purchase, sold and leased back in order for them to be available for use by [A] in its worldwide shipping operations.

A chassis is pulled by the tractor unit of a truck and can be used to carry cargo containers on highways. Chassis are skeletal in nature and are not enclosed like trailers. Containers can be used for shipping goods and can be carried either at sea on ships or on land on a chassis.

The containers are manufactured abroad, in [X] and [Y] and [A] will take delivery of them at the manufacturer's premises. They will be placed in service at the earliest possible moment in the course of [A]'s worldwide shipping business. From time to time and during the course of [A]'s worldwide shipping business, the purchased containers will be brought into California ports where they will be loaded onto chassis or onto railroad flatbed cars for delivery to other locations within and without California. The cargo containers will enter California loaded with goods, and after delivery of the goods, the containers will continue to be used by [A] in its shipping business throughout the world.

In all cases, title to the containers will pass to [A] outside of California, usually outside the United States. [A] will subsequently sell the containers to the Trust and simultaneously lease them back. At the time of transfer to the Trust and the leaseback to [A], the containers will be physically located either outside of California, on the high seas, in a foreign country, or within California while being used in the course of [A]'s worldwide shipping operations.

The chassis will be manufactured within the United States in several different states including California, but the bulk of them will be purchased outside of California and sent to this state for use here as described above. Title to the chassis will pass to [A] while they are located at the manufacturer's premises, and the manufacturer's will deliver them to their ultimate destination, which will be California in most cases. For the brief period between, [A]'s acquisition of the chassis and their resale to the Trust, [A] will not make any use of the chassis, but instead will merely hold the chassis for resale to the Trust. Following the sale by [A] to the Trust, and leaseback to [A], [A] will use the chassis, but within and without California, in connection with the import and export of goods which are carried in the containers. [A] is engaged in the shipping business and is not required to hold a seller's permit for its shipping operations. [A], however, has recently obtained a seller's permit from the Board and plans to issue resale certificates to the manufacturers upon purchase of the chassis. During the last year, [A] has not made any retail sale in the State of California.

[A], as operator of the fleet of chassis, will register the chassis in California. It is your understanding that California registration of the chassis is required under California Vehicle Code §4000.4 and 6704, because [A] maintains a place of business in California and will base the fleet in California. With regard to the chassis [A] intends to use partly in California and partly in other states, [A] will register and license them under California Vehicle Code Section 8151, which provides for proportionate registration and licensing of vehicles operated in California in interstate commerce.

Although the transaction contemplated is governed by one master agreement, there will occur multiple deliveries of both containers and chassis to the Trust over a period of approximately four months. Apparently, [A] must take title to the containers and chassis for a brief period of time before they are sold to the Trust in order for [A] to take advantage of favorable maritime financing for the acquisition. As noted above, [A] will not use the chassis before reselling them to the Trust but, in most cases, [A] will use the containers for shipping goods before transferring title to the containers to the Trust. Any use of the containers by [A] before reconveyance to the Trust will occur while the containers are located outside of California in foreign commerce when they are put to their first functional use.

The rulings which you request an our answers are as follows:

“1. The sale of the chassis to [A] is exempt from sales and use tax because it is a sale for resale.”

Answer:

Assuming that [A] does not make any use of the chassis it purchases from the manufacturers other than retention, demonstration, or display while holding them for resale to the Trust, it is our opinion that neither sales nor use tax applies to the acquisition of the chassis by [A]. Since [A] desires to engage in business as a seller in California, it properly applied for and received a California seller's permit (Rev. & Tax. Code §§6014, 6066, Reg. 1699, copy enclosed). Because [A] is the holder of a seller's permit, it can purchase the chassis from the manufacturer ex-tax by giving them resale certificates, as provided for in Sales and Use Tax Regulation 1668 (copy enclosed). The effect of these resale certificates is to release the sellers from both the liability for the sales tax and the duty of collecting use tax, provided the resale certificates are timely taken by the sellers in good faith.

“2. The sale of the containers to [A] is exempt from sales and use tax because it is a sale for resale.”

Answer:

In our view, the sale of the containers to [A] is not an exempt sale for resale, notwithstanding the fact that [A] will ultimately resell them to the Trust. It is settled law in California that the eventual sale of tangible personal property by a person who has purchased the property for use prior to its resale will not prevent the original sale from being subject to tax. (Safeway Stores v. State Board of Equalization, 148 C.A.2d 299). Section 6007 of the Revenue and Taxation Code defines the term “retail sale” to mean a sale for any purpose other than resale in the regular course of business. Sections 6094 and 6244 provide that tax applies when tangible personal property is purchased ex-tax from a retailer but is used (other than retention, demonstration, or display) prior to its resale. According to the facts, [A] will place the purchased containers into use in its worldwide shipping business carrying cargo prior to the sale and leaseback of the containers from the Trust. Such intervening use by [A] prior to resale is substantial and clearly constitutes use other than retention, demonstration, or display. Therefore, it is our opinion that the sale of the containers to [A] is not an exempt sale for resale.

As discussed in our answer to numbers 3 and 4 below, [A] purchases of the containers may or may not be subject to tax for other reasons.

“3. The sale of the containers to [A] is exempt from sales and use tax because the containers are to be used exclusively in foreign and interstate commerce.”

Answer:

With regard to the application of sales tax to the sale of the containers to [A], section 6051 of the Revenue and Taxation Code imposes a tax on all retailers based on the gross receipts from the sale at retail of tangible personal property in this state. Section 6010.5 provides that the place of the sale or purchase of tangible personal property is the place where the property is physically located at the time the act constituting the sale or purchase takes place. Sales and Use Tax Regulation 1620(a)(1) (copy enclosed) provides that if title to the property sold passes to the purchaser at a point outside this state, or if for any reason the sale occurs outside this state, the sales tax does not apply, regardless of the extent of the retailer's participation in California in relation to the transaction. Presumably, title to the containers will pass to [A] when delivery is made outside California. Accordingly, the sale of the containers to [A] will take place outside this state and is not subject to sales tax.

Although a transaction may not be subject to the sales tax, the purchaser may nonetheless be liable for a use tax in situations where, as in the present case, the purchaser intends to use the property in California (Rev. & Tax. Code § 6201). Regulation 1620(b)(1) states the general rule that use tax applies with respect to any property purchased for storage, use, or other consumption and stored, used, or consumed in this state, the sale of which is exempt from sales tax under subdivision (a) of Regulation 1620. an exception to this general rule is provided under subdivision (b)(2)(B) of Regulation 1620 which provides:

“Use tax does not apply to property purchased for use and used in interstate or foreign commerce prior to its entry into this state, and thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California.”

In determining whether or not property is purchased for use in this state, Regulation 1620(b)(3) provides the following presumptions:

“Property purchased outside of California which is brought into California is regarded as having been purchased for use in this state if the first functional use of the property is in California. When the property is first functionally used outside of California, the property will nevertheless be presumed to have been purchased for use in this state if it is brought into California within 90 days after its purchase, unless the property is used or stored outside of California one-half or more of the time during the six-month period immediately following its entry into this state. Prior out-of-state use not exceeding 90 days from the date of purchase to the date of entry into California is of a temporary nature and is not proof of an intent that the property was purchased for use elsewhere. Prior out-of-state use in excess of 90 days from the date of purchase to the date of entry into California, exclusive of any time of shipment to California, or time of storage for shipment to California, will be

accepted as proof of an intent that the property was not purchased for use in California.

For purposes of this subparagraph 'functional use' means use for the purposes for which the property was designed."

Based on our understanding of the facts, it appears to us that the first functional use of the containers by [A] will occur when the containers are located outside of California in interstate or foreign commerce, and that some containers will be brought into California within 90 days after their purchase. Although it is not without some doubt, [A] may also use some of the containers outside California in excess of 90 days from the date of purchase prior to their entry into California.

Therefore, with regard to the containers brought into California within 90 days after their purchase by [A], the containers are presumed to be purchased for use in this state and subject to use tax, unless [A] either (i) uses the containers in interstate or foreign commerce prior to their entry into California and continuously uses them thereafter in interstate or foreign commerce as provided under Regulation 1620(b)(2)(B), or (ii) uses the containers outside of California one-half or more of the time immediately following their entry into California as provided under Regulation 1620(b)(3). Use tax would not be applicable to any in-state use of the containers by [A], however, if [A] uses the containers outside of California in excess of 90 days from the date of purchase to the date of their entry into this state, exclusive of the time of their shipment unloaded with cargo to California.

"4. The sale of the containers to [A] is exempt from sales and use tax because the sale will take place outside of California and the containers will be put to their first functional use outside the State of California."

Answer:

With regard to the application of sales tax, we agree with your conclusion that the sale of the containers to [A] is not subject to sales tax, provided the sale to [A] occurs while the property is physically located outside of the state.

Although the sale is not subject to a sales tax and the first functional use of the containers takes place while the containers are located outside of California, use tax would nevertheless apply to [A]'s use of the containers in California if the containers enter this state within 90 days from the date of purchase, and are not continuously used in interstate or foreign commerce, or are not used by [A] outside of the state at least 50 percent of the time over a six month period (see our answer to number 3 above).

"5. The sale of the containers by [A] to the Trust is exempt from sales and use tax because the containers are to be used exclusively in foreign and interstate commerce."

Answer:

It is [A]'s intention to ultimately sell the purchased containers to the Trust, and the Trust will in turn lease the containers back to [A]. In most cases, the sales to the Trust will take place while the containers are situated outside of California. Therefore, pursuant to Regulation 1620(a)(1), it is our opinion that sales tax does not apply to these particular out-of-state container sales to the Trust.

Apparently, title to some containers may pass to the Trust at a time when the containers are physically located within California. In such an event, it is our opinion that there is a taxable retail sale of the containers in California, notwithstanding the fact that the containers are purchased by the Trust for use in interstate or foreign commerce. Sales and Use Tax Regulation 1620(a)(3)(A) provides that sales tax applies when property is delivered to the purchaser or his representative in this state even though the intention of the purchaser is to transport the property outside this state. The rationale behind this regulation is that when title to the property sold passes to the purchaser, the sale is complete and has taken place within this state; no burden on interstate commerce exists under such circumstances.

With regard to taxable container sales to the Trust, [A], as the retailer, is liable for sales tax measured by the gross receipts from the sale (Rev. & Tax. Code §§6012, 6051). Since the cargo containers qualify as mobile transportation equipment ("MTE") under Revenue and Taxation Code Section 6023 and Regulation 1661(a) (copy enclosed), the Trust, as lessor of the MTE, may make a timely election to report the tax measured by the fair rental value as provided in subdivision (e)(2) of Regulation 1661. (See our answer to number 10 below for a full discussion of this particular election.)

Although sales tax does not apply to an the out-of-state purchase by the Trust, the Trust as the lessor may nevertheless be liable for a use tax where the property is purchased for lease in California. In such an event, [A] may be under a duty to collect the use tax pursuant to Sections 6203 and 6247.

Regulation 1661(f) provides that if the sale and delivery of MTE occurs outside of California and the property is "purchased for use" in California by the lessor, use tax will apply measured by the purchase price unless the equipment enters the state in interstate commerce, or the lessor makes a timely election to report his use tax liability measured by the fair rental value as provided in Regulation 1661(e)(2).

It is our position that where the containers are first functionally used by the Trust outside of California in interstate or foreign commerce, the containers are nevertheless presumed to have been "purchased for use" in this state if they are brought into this state within 90 days from the date of sale to the Trust (Regulation 1620(b)(3)). This presumption does not apply, however, under the following conditions: (i) the property is used or stored outside of California one-half or more of the time during the six-month period following its entry into California (Regulation 1620(b)(3); or (ii) the property is purchased for use and is used in interstate or foreign commerce prior to its entry into this state, and thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California (Regulation 1620(b)(2)(B)). Therefore, the

Trust will not be liable for a use tax as the consumer of the leased containers used in this state where the Trust can show that either conditions (i) or (ii) apply. If neither condition applies, the Trust's purchase of the containers from [A] is subject to a use tax.

If use tax applies, the Trust can timely elect to pay the use tax measured by the fair rental value of the leased property (Regulation 1661(f) and (e)(2)).

"6. The sale of the chassis to [A] is exempt from sales and use tax because the chassis are to be used exclusively in foreign and interstate commerce."

Answer:

In our view, neither a sales tax nor a use tax will apply if [A] purchases the chassis for resale to the Trust provided [A] merely holds or stores the chassis and makes no use of the chassis other than retention, demonstration or display prior to their sale.

An exemption based upon use in interstate or foreign commerce would not apply in the present case for the reason that the chassis will not be put into interstate or foreign commerce by [A] prior to their entry into this state, as is required by Regulation 1620(b)(2)(B).

"7. The sale of the chassis by [A] to the Trust is exempt from sales and use tax because the chassis are to be used exclusively in foreign and interstate commerce."

Answer:

In our view, [A]'s sale of the chassis to the Trust is a retail sale and is subject to tax if the sale takes place while the chassis are physically located within the State of California. There is no interstate or foreign commerce exemption with regard to such sales since the sales occur within the state.

If the sale to the Trust occurs while the chassis are physically located outside the state, there is no sales tax liability. There may, however, be use tax liability, depending upon the particular facts involved.

The chassis are presumed to be purchased for use in California and subject to use tax if the chassis are purchased by the Trust outside of California but are first functionally used in California (Regulation 1620(b)(3)). If, on the other hand, the first function use of the chassis occurs outside of the state after the sale to the Trust, a use tax will nevertheless apply if the chassis are brought into California within 90 days from the date of purchase from [A] except where (i) the chassis are used or stored outside of California one-half or more of the time during the six month period following their entry into this state; or (ii) the chassis are used continuously in interstate or foreign commerce before and after their entry into California. (See Regulation 1661(f), Regulation 1620(b)(3), Regulation 1620(b)(2)(B), and our answer to number 5 above regarding the taxable use of the containers).

The chassis which are used in excess of 90 days outside of this state prior to their entry into California are presumed not to be purchased for use in California and are therefore not subject to use tax. (Regulation 1620(b)(3).)

In the event that the Trust's purchase is subject to either sales or use tax, the measure of tax would be the gross receipts or sales price of the chassis, unless the Trust, as the lessor of mobile transportation equipment, makes a timely election to pay use tax measured by the fair rental value of the leased property (see our answer to numbers 9 and 10 below for a full discussion of this election).

"8. The sale of the containers by [A] to the trust is exempt from sales and use tax because it is an occasional sale."

Answer:

Section 6367 of the Revenue and Taxation Code exempts from either sales or use taxes the occasional sale of tangible personal property. Section 6006.5(a) defines an "occasional sale" to be a sale of property not held by a seller in the course of activities for which he is required to hold a seller's permit, or would be required to hold a seller's permit if the activities were conducted in this state, provided such sale is not one of a series of sales sufficient in number, scope, and character to constitute an activity requiring a seller's permit.

Subsection (a) of Sales and Use Tax Regulation 1595 (copy enclosed), which interprets and applies Sections 6006.5 and 6367, provides that tax applies to all retail sales of tangible personal property held or used by the seller in the course of an activity or activities for which a seller's permit is required or could be required, if the activity or activities were conducted in this state. This subsection further provides that a seller's permit must be held by a person who either makes three or more sales for substantial amounts in a period of 12 months, or makes a substantial number of sales for relatively small amounts.

Therefore, even though [A] has not made any retail sales in California during the past year, an occasional sale exemption would not be available to [A] if it makes three or more sales of tangible personal property anywhere in the world within a 12 month period.

From the facts of the transaction in question, it appears that [A] will make more than three separate sales within a 12-month period when it sells the containers or chassis to the Trust. As we understand it, [A] will not be transferring titles to all containers at once to the Trust. Instead, there will be numerous deliveries to the Trust shortly after the containers are manufactured and received by [A]. Therefore, since [A] would be required to hold a seller's permit if such retail container sales were conducted in this state, it is our opinion that the container sales by [A] to the Trust will not qualify as exempt occasional sales under Regulation 1595.

Nevertheless, as indicated earlier, [A] properly has obtained a California seller's permit since it wished to engage in activities in California as a seller. [A] is admittedly engaged in the business of selling tangible personal property when it issues resale certificates to the chassis manufacturers. Clearly, [A]'s container sales to the Trust are also part of this business activity of selling tangible personal property to the Trust for lease in this state. Therefore, since [A] is a seller

with regard to both the container and chassis sales, an occasional sale exemption would not be available to [A] for the sales of the containers to the Trust.

“9. The leaseback to [A] by the Trust of the containers and chassis is not subject to sales or use tax because it is a lease of mobile transportation equipment.”

Answer:

We agree. Leases of mobile transportation equipment (“MTE”) such as chassis and cargo shipping containers are not considered “sales” or “purchases” pursuant to Revenue and Taxation Code Sections 6006(g)(4) and 6010(e)(4), and hence are not subject to sales or use taxes. Generally, tax applies to the sale of the MTE to the lessor who is considered to be the consumer of the equipment purchased for lease to others. Therefore, although the lease of MTE is not subject to tax, tax applies to the sale or purchase of the chassis and cargo containers by the Trust, unless the sale or purchase is otherwise nontaxable.

“10. If sales and/or use tax is due on the sale of the containers and chassis to the Trust, the Trust may elect to pay the tax in increments based on the lease payments received over the duration of the lease.”

Answer:

We agree. Pursuant to Regulation 1661(f), lessor who purchase MTE with the intention of leasing it may issue their vendors a resale certificate and elect to report their use tax liability based on the “fair rental value” of the property, provided this election is made on or before the due date of a return for the period in which the equipment is first leased (Revenue and Taxation Code Sections 6092.1, 6094, 6243.1 and 6244, and Regulation 1661(e)).

Therefore, where either the sales or use tax applies to the Trust’s purchase of the chassis or containers, the Trust can issue a resale certificate to [A] and elect to pay tax measured by the “fair rental value” of the MTE. You should note that once this election is made, the Trust must report the tax based on the fair rental value of the property whether the MTE is located within or without this state (Reg. 1661(e)(2)).

Very truly yours,

Charles J. Graziano
Tax Counsel

CJG:ba

Enc. Regulations 1699, 1668, 1620, 1661, 1595

cc: Ms. K--- J. S---